



Volume XVII

APRIL 30  
1948

Number 19

*As I sell*

### SOME \$64 QUESTIONS

**D**URING the past few weeks we have gotten questions from various types of clients asking about the present situation. These questions have covered many different subjects, but can be grouped under the following headings: real estate and mortgage operators; building contractors; building material dealers; and building material manufacturers.

I think that probably the most frequent questions from real estate and mortgage operators deal with the future of real estate prices.

What will happen to construction costs? Relatively little change in construction costs through the first three quarters of the year is expected. There is a probability of a drop in the last quarter. As a general principle, things that have gone up most will probably show the largest drop. Lumber is expected to drop by a larger percentage than any other major construction material, but no drops comparable to the drops of 1920 and 1921, when the average wholesale prices of lumber dropped by 59 per cent in sixteen months. Probably a 25 to 30 per cent drop in lumber prices can be expected some time prior to 1950. It may come in a relatively short period during the latter part of this year and the early part of 1949, or it may be a gradual decline, spread over several years.

What will happen to the selling prices of residences from 30 to 50 years old? It seems to me that regardless of the amount of additional inflation we may get, older, more obsolete residences will decline in price as the housing shortage eases. In a scarcity market the average individual allows an insufficient amount for depreciation and obsolescence in his general thinking on values, and an older house will often sell for a relatively high price in comparison with new buildings, but this condition lasts only during the period of the scarcity. Beware particularly of older residential buildings in which plumbing and heating are inadequate by modern standards. There is a strong probability that most cities, so soon as the housing shortage is over, will pass rather stiff legislation against the continued use of these buildings. Many cities which have passed such legislation in the past but have not enforced it will then insist on compliance. In a normal market these buildings do not have sufficient economic value to warrant making the extensive and expensive changes required to comply with health and safety standards. Many of these buildings in the fifties will be boarded up or will be torn down to save taxes. Some of these buildings in the recent past have changed hands at values possible only because of the high scarcity premium which any type of housing carried.

What will happen to the selling prices of residential buildings less than 30 years old? Modern buildings built before 1939 will sell at a higher price than they brought

in 1939, even though we should go into a drastic depression. It seems to me that even a depression of the severity of the thirties would not be apt to bring values down to the point where they were in 1939 on well-located and well-built, non-obsolete residential buildings. Over the long period the values of existing buildings depend primarily on replacement cost less depreciation. Replacement costs are permanently higher due to many monetary and other factors, with no chance of returning to their former levels. The most pessimistic forecast we have made on the values of residential buildings assumes that in 1955, if we are at the bottom of a depression of the 1932 variety, the cost of building our standard six-room frame house will still be 15 per cent above the highest point in the building boom of the twenties, will be at least 40 per cent above the 1939 level at the time that the war started in Europe, and will be at least 73 per cent higher than building costs at the bottom of the big depression of the thirties.

What will happen to the prices of apartment buildings? I am still in a state of indecision on the best policy to be followed on larger apartment buildings of medium sized units. If these buildings are well located and are modern, I am inclined to think that I would continue to hold them if I owned them clear at the present time, or if I had a very substantial equity, in spite of the fact that in some ways they will undoubtedly eventually suffer from the competition of many 608 projects which are being built in large numbers in most cities at the present time. If I had only a slim equity, I would sell.

What will happen to the prices of commercial buildings? There will continue to be a tight market for office space in the near future. Construction costs are so high that only a very few office buildings are being erected to compete with the older ones. Vacancies in office buildings are near an all-time low all over the country, and so long as construction costs remain high and vacancies low, these existing buildings should enjoy smooth sailing. The pattern of booms in the past has been for office buildings, large apartment buildings and hotels to reach their peaks later than other types of property. If I owned a store building clear, in a good established location, that could be leased for a long period, I could sell at a higher price now than four or five years from now. I believe that retail sales are pretty much at their peak and as they fall, so will rents and values of established commercial properties.

There are many commercial properties developing in outlying areas which have not yet reached their peak in value. While this is true as a general thing, beware of the speculative spirit which in some developing subcenters has pushed land values above any amount which the land can logically earn. We have seen some subcenter locations which in the recent past have been leased for long periods for an amount which, in our opinion, is not justified.

What will happen to the prices of farms? The selling prices of farms should theoretically be the present value of all future benefits which could be derived from ownership. Unfortunately, however, the farm-buying public generally capitalizes the earnings of the very recent past, and assumes that these earnings will continue indefinitely into the future. This assumption is always wrong. If it is made during a depression period, it results in selling prices of farms very much below their actual long-term values. If it is made at the top of a land boom, it results in selling prices far higher than the future income of the farms would justify. I believe that farm values have reached their peak, or will reach it this spring. The prices of farm products should start to slide some time this fall and as they start down, the values



of farms will not be far behind. There is no chance, however, of a drop in farm values so drastic as the drop in the twenties.

How much government interference will there be with the ownership, operation and transfer of real estate? The cost of local government has gone up and I think it is inevitable that it will go higher. Real estate taxes have been reserved primarily for the maintenance of local government and are sure to be increased still more. As pointed out under the section dealing with older residential properties, I think that most cities by the middle fifties will enforce such strict legislation against substandard housing that the prices of many such properties will be deflated to a point where they have no economic value. The buildings will be either boarded up to await the next housing shortage, or will be torn down to save taxes. It is possible as the crusade for public housing becomes more zealous, that even stricter enforcement of legislation may be resorted to in order to make substandard housing so unprofitable that the owners will be forced to sell. If a major depression develops in the middle fifties, I think it entirely likely that mortgage moratoriums may become somewhat general and that the HOLC will be re-expanded primarily to prevent foreclosures of GI loans and other mortgages.

I believe that there will be a further gradual relaxation of rent control. This is eventually being brought about by the slackening of the housing shortage and by the fact that new buildings not under rent control are providing a larger and larger percentage of the housing. The rent control provisions which decontrolled the rents on new dwelling units stimulated building and paved the way for eventual total decontrol. Had rent control been held on new construction, a great deal less new construction would have resulted. This would have prolonged the housing shortage and made the elimination of rent control on existing buildings a much more difficult problem than it is at present.

Capital gains tax provisions at the present time are favorable, with the exception of the tax on the individual who has owned his own home and who has found it necessary to sell the building and repurchase, either in another neighborhood or another city. This individual may have purchased a residence at \$6,000 which he sells for \$14,000. He may have spent \$1,000 on improvements, leaving him a capital gain of \$7,000, on which he would pay a maximum tax of 25 per cent, or \$1,750. It may be necessary for him to pay \$14,000 for an identical building, in which case he ends up with a building no better than the one he had before, but his income tax has taken \$1,750 from his assets. There is a bill pending in Congress which will exempt the capital gains on the sale of a home, providing the money is used to purchase another home within six months, but there is no assurance that this or any other substantially remedial capital gains legislation will be passed any time soon. On the other hand, I doubt very seriously whether any change will be made in the capital gains tax as it affects real estate which will be less favorable than the arrangements we have at present.

The most frequent questions from mortgage operators were:

Will it be easier to get a mortgage commitment during the balance of 1948 from a mortgage lender, than it has been in the first few months? I think that there is a decided possibility that mortgage lending may loosen up slightly as the year advances.

Will mortgage interest rates continue to rise or will they move sideways during

the balance of the year? Mortgage interest rates will continue to move sideways with a tendency toward an upward drift. I think that we have seen the last of rock bottom rates for some time to come.

Most building contractors and building material dealers and manufacturers wanted to know:


Will building volume continue to run ahead of last year? Building volume, already 15 per cent ahead of last year, will continue to stay ahead at least during the summer months. I will feel a great deal safer in reserving my forecast regarding the last quarter until about the middle of September.

What types of houses will meet the least sales resistance? At today's cost, nearly all types of houses will meet strong sales resistance. It seems to me, however, that the community property ruling in the new tax bill will lead to construction of a greater number of more expensive homes in those States which have not had community property legislation in the past.

How long do you expect the housing boom to last? I think that the housing boom will hit its peak this year and will fall off each year until near the middle fifties. The peak of the last boom came in 1925, with 937,000 nonfarm dwelling units started. Eight years later, in the depths of the real estate depression, 93,000 units were started. As the bloom falls off the boom I expect a larger number of government subsidized public housing projects to get under way.

When do you think that labor will be easier to get? In some sections and in some of the trades, labor is already easier to get. If 1948 is the peak construction year, and I believe that it will be, the labor supply (and attitude) should begin to show marked improvement in 1949, providing we do not put too many of our building mechanics into the armed forces. Regardless of what we plan, the lurking Russians must be considered, so we must make mental allowance at least for the possibility of a draft to meet our military requirements. I believe that we will get by the balance of the year without the draft and that if it does come later on, say in 1949, builders will have a good deal more to occupy them than residential construction.

What type of government action can we expect regarding materials? Barring war or serious threat of war, I think the government will keep "hands off" of the building materials situation. The supply of materials is slowly improving, although builders are still dogged by chronic shortages in certain lines - nails and soil pipe, for instance. The outlook for lumber supplies grows brighter and brighter, and will continue to improve now that bad weather has released its hold on the southern mills. If I were a lumber dealer, I would buy hand-to-mouth and watch credit to customers very closely. I would not spread out too thin.

  
ROY WENZLICK